



A REPORT  
TO THE  
**ARIZONA LEGISLATURE**

Accounting Services Division

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Compliance Review

# **Nazlini Community Junior High School**

Year Ended June 30, 2003

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STATE OF ARIZONA  
OFFICE OF THE  
**AUDITOR  
GENERAL**

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**Debra K. Davenport**  
Auditor General

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DEBRA K. DAVENPORT, CPA  
AUDITOR GENERAL

**STATE OF ARIZONA**  
**OFFICE OF THE**  
**AUDITOR GENERAL**

WILLIAM THOMSON  
DEPUTY AUDITOR GENERAL

July 12, 2004

Governing Board  
Nazlini Community Junior High School  
HC 58, P.O. Box 35  
Ganado, AZ 86505

Members of the Board:

We previously notified you that the School had not complied with the *Uniform System of Financial Records for Arizona Charter Schools* (USFRCS) due to deficiencies in the School's internal controls. We have since reviewed the School's audit reports and USFRCS Compliance Questionnaire for the year ended June 30, 2003, to determine whether the School was in compliance with the USFRCS as of that date.

Based on the number and nature of the deficiencies noted in our review, the School still has not complied with the USFRCS. Additionally, the auditors disclaimed an opinion on the School's financial statements for the year ended June 30, 2003, due to inadequate accounting records and internal controls. This is the fourth consecutive year the auditors have been unable to issue an opinion on the School's financial statements. Within a few days, we will issue a letter notifying the Arizona State Board of Education of the School's noncompliance and requesting that the Board take appropriate action as prescribed by Arizona Revised Statutes §15-272.

Recommendations to correct deficiencies noted in our review are described in this report. School management should implement these recommendations to ensure that the School fulfills its responsibility to establish and maintain internal controls that will adequately comply with the USFRCS. We have communicated specific details for all deficiencies to management for correction.

My staff and I will be pleased to discuss or clarify items in this compliance review report.

Sincerely,

Debra K. Davenport  
Auditor General

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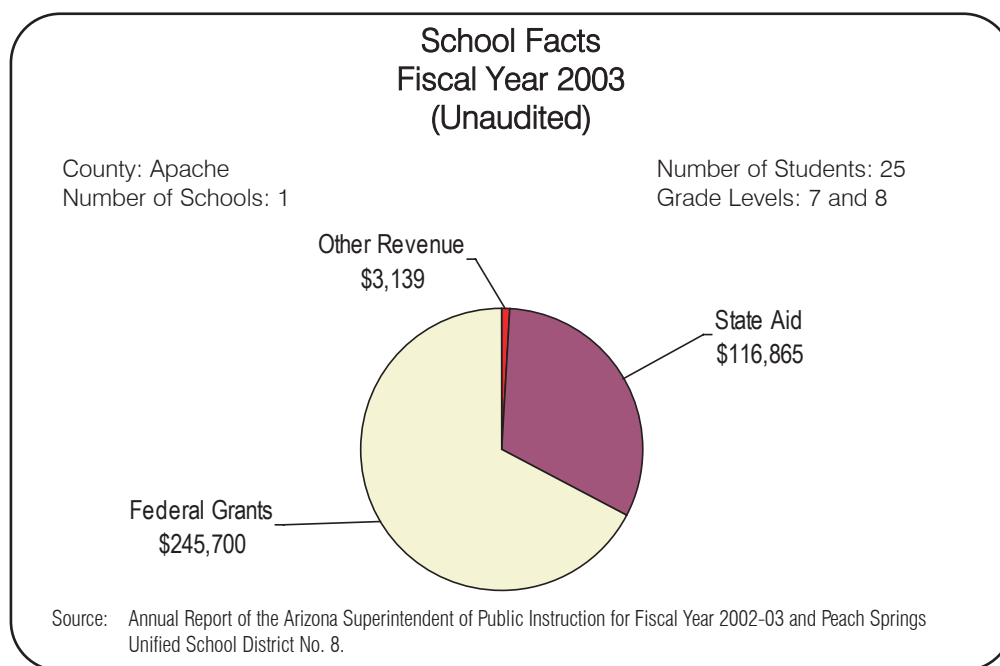
## INTRODUCTION

Nazlini Community Junior High School is accountable to its students, their parents, and the local community for the quality of education provided. The School is also financially accountable for over \$365,000 it received in fiscal year 2002-03 to provide this education.

The School should use effective internal controls to demonstrate responsible stewardship for the dollars it receives. These controls are set forth in the *Uniform System of Financial Records for Arizona Charter Schools* (USFRCS), a joint publication of the Office of the Auditor General and the Arizona Department of Education. The policies and procedures in the USFRCS incorporate finance-related state and federal laws and regulations, and generally accepted accounting principles applicable to charter schools. Schools are legally obligated to comply with USFRCS requirements, and doing so is good business practice.

As a result of our review of the School's audit reports and USFRCS Compliance Questionnaire for the year ended June 30, 2003, we determined that the School has failed to comply with the USFRCS. Also, since the School has not established effective internal controls or maintained adequate accounting records for several years, the School's auditors have been unable to issue an opinion on the School's financial statements for the past 4 years.

We noted certain deficiencies in controls that the School's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate financial stewardship, and to comply with the USFRCS. Our recommendations are described on the following pages.



# The School must maintain adequate accounting records and establish stronger controls over its financial operations

The School's auditors could not express an opinion on the School's financial statements for the last 4 years because of inadequate accounting records and internal controls.

Arizona Revised Statutes require charter schools to have annual audits of their financial statements. Therefore, the School should prepare financial statements in accordance with generally accepted accounting principles and submit its audited financial statements to the Auditor General's Office within 9 months of the fiscal year end. In order to prepare accurate financial statements, the School must maintain adequate accounting records. The School must also have strong internal controls to ensure the reliability of its accounting records. However, since the School's inception in fiscal year 2000, the School has failed to maintain adequate accounting records and internal controls. As a result, the School's auditors have not been able to determine if the School's financial statements were fairly stated or could be relied upon for the past 4 years. In addition, for 3 of the past 4 years, the School submitted its audited financial statements 4 to 15 months after the due date.

Because of the School's failure to maintain adequate accounting records and internal controls, we found the School in noncompliance with the USFRCS for fiscal year 2000. The audit reports for fiscal years 2001, 2002, and 2003 indicate that the School has made little progress over the past few years in correcting the deficiencies originally cited in fiscal year 2000.

## Recommendation

To help ensure that the School's accounting records and financial statements are accurate and complete, and that its annual financial statements are issued timely, the Governing Board should establish written policies and procedures for processing and recording the School's financial transactions in its accounting system. Essential to an effective accounting system is a system of internal control that provides a plan of organization, adequate internal checks and balances, and sufficient supporting records to ensure that assets are safeguarded and accounting records are accurate and complete. The USFRCS §VI, Accounting Procedures describes in specific detail the policies, procedures, and recordkeeping methods for an effective accounting system for Arizona charter schools. The School should also ensure that personnel are adequately trained to successfully implement the accounting system policies and procedures, and school management should monitor that those policies and procedures are followed.

# The School should properly allocate expenses between the Charter School and the Bureau of Indian Affairs School

The School's Governing Board also operates Nazlini Community School that is funded primarily by the Bureau of Indian Affairs (BIA). The charter school is located on the premises of the BIA school. The U.S. Department of the Interior has decided that BIA resources may not be used to support state charter schools. However, the School has used BIA resources to support the charter school, since the School's formula for allocating expenses between the charter school and BIA school was not accurately applied. Further, the charter school has not reimbursed the BIA school for these errors.

## Recommendation

The Governing Board should ensure that monies of the two schools are kept separate and that BIA monies are not used for charter school purposes. Any shared costs should be allocated between the schools on a reasonable and consistent basis. Accounting personnel should document the allocation of shared expenses to support the allocations' accuracy and completeness. Also, the School should return BIA monies used to pay its expenses to Nazlini Community School.

# The School should prepare and maintain a complete capital assets list

The School used financial resources to purchase capital asset items, such as equipment. Effective stewardship requires the School to have an accurate list of these assets and to ensure they are properly identified and accounted for. However, the School did not have a complete capital assets list, retain invoices supporting capital asset purchases, and perform a physical inventory of its equipment. As a result, the School could not update its capital assets list annually and prepare appropriate reconciliations to help ensure the list is complete and accurate.

The School failed to properly maintain a capital assets list for, or periodically inventory, its capital assets, making them susceptible to loss or theft.



USFRCS §VI-E describes the information that should appear on the capital assets list, and provides sample capital asset reconciliation forms and instructions for performing a physical inventory of capital assets.

## Recommendations

The following procedures can help the School improve controls over its capital assets and ensure that its capital assets list is accurate and complete:

- Prepare and maintain a detailed capital assets list of all equipment items costing \$300 or more and with useful lives of 1 year or more, and all land, buildings, and related improvements costing \$3,000 or more.
- Include all required information for each item on the capital assets list.
- Retain supporting cost documentation for all capital assets, and verify that each asset's cost recorded on the list agrees with the supporting documentation.
- Update the capital assets list annually for items acquired or disposed of.
- Reconcile items added to the capital assets list during the fiscal year to capital purchases and changes in asset accounts in the general ledger for that year, and the prior year's capital assets list to the current year's list, and make all necessary corrections.
- Perform a physical inventory of all equipment items at least every 3 years, and at least every 2 years for equipment items costing \$5,000 or more purchased with federal monies. Assign an employee who has no custodial responsibilities to reconcile the physical inventory results to the list, and add items to or remove items from the list as necessary.

## The School's controls over cash receipts and bank accounts should be strengthened

Poor cash controls left school cash susceptible to theft or loss.

Because of the relatively high risk associated with transactions involving cash, charter schools should establish and maintain effective internal controls to safeguard cash. However, the School did not have effective controls for cash received, as the School did not prepare prenumbered and numerically controlled cash receipt forms and daily cash receipt summaries. In addition, the School did not physically safeguard cash receipts prior to deposit, or reconcile validated bank deposit receipts to copies of bank deposit slips. Further, the School did not reconcile the revolving account general ledger to the bank statement, and did not insure or collateralize bank deposits in excess of \$100,000.

## Recommendations

The following policies and procedures can help the School ensure that cash is properly safeguarded and recorded:

- Prepare prenumbered and numerically controlled cash receipt forms for amounts received and restrictively endorse checks and warrants when received.
- Prepare daily cash receipt summaries and reconcile the amount of cash, checks, and warrants received to receipt forms.
- Place undeposited cash receipts in a locked safe or cabinet.
- Compare validated bank deposit receipts to the total amount of cash receipts on the cash receipt summaries, bank deposit slip copies, and supporting documentation. Investigate and resolve all differences.
- Reconcile the revolving cash account in the general ledger to the revolving account bank statement monthly and make all necessary corrections.
- Obtain a collateral agreement from the bank for balances on deposit in excess of \$100,000, the Federal Deposit Insurance Corporation threshold.

USFRCS pages VI-F-1 through 3 provide policies and procedures for recording cash receipts.

## The School should establish stronger controls over disbursements

The School spends public monies to purchase goods and services, so it is essential that the School follows procedures that help ensure that these monies are spent appropriately and recorded properly. However, the School did not always track blanket purchase orders, prepare receiving reports, and cancel supporting documents when paid. Further, the School did not prepare a list of liabilities for goods or services received, but not paid for on or before the end of the fiscal year.

The School's procedures were not adequate to ensure that monies were appropriately spent and properly recorded.

## Recommendations

To help strengthen controls over disbursements, the School should establish and follow the policies and procedures listed below:

- Ensure that blanket purchase orders include a definite time period and a specific dollar limit. Deduct invoice amounts paid against a blanket purchase order from the total limit to determine the unspent balance remaining.

- Prepare receiving reports for all goods and services received. The receiving report should include the date of receipt, quantity received, items' condition, and signature of the employee receiving the items.
- Cancel the invoice and supporting documents by recording voucher and check numbers on the invoice after payment to prevent subsequent use.
- Prepare a list of liabilities at fiscal year end of goods or services received on or before June 30 that were not paid by that date.

## The School must follow competitive purchasing requirements

School District Procurement Rules for competitive sealed bidding and USFRCS guidelines for purchases below the competitive sealed bid threshold promote open and fair competition among vendors. This helps ensure that schools receive the best possible value for the public monies they spend. However, the School did not follow the School District Procurement Rules or the USFRCS guidelines. All of the School's purchases were classified as sole source or only required oral price quotations. For purchases classified as sole source, the School did not retain written documentation of the Governing Board's determination that there was only one source for the required material, service, or construction item. Also, the School did not obtain oral price quotations when required.

The School may not have received the best value possible for goods and services, as purchases were classified as sole source without written documentation of the Board's determination that the materials, services, or construction items were only available from one vendor.

## Recommendations

To strengthen controls over competitive purchasing, the School should establish and follow the policies and procedures listed below:

- Only award a contract for materials, services, or construction items without competition when the School's Governing Board has determined that there is only one vendor from which to purchase the item and retain that written determination with other supporting documents. Sole source procurement should be avoided, except when no reasonable alternative vendor exists.
- In the event the School makes a purchase costing more than \$35,000 that is not determined to be sole source, follow the School District Procurement Rules and obtain competitive sealed bids or proposals.

- Obtain oral price quotations from at least three vendors for purchases estimated to cost between \$5,000 and \$15,000, and written price quotations from at least three vendors for purchases estimated to cost between \$15,000 and \$35,000. The purchase may be a single item within the price range, or it may be a collection of items that, in the aggregate, are within the price range. If the School cannot obtain three price quotations, it should document the vendors contacted and their reasons for not providing quotations.